United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

75-7616

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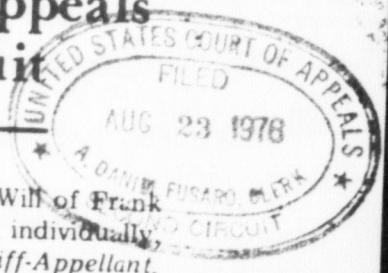

ROSALIE M. ARLINGHAUS, Executrix of the Will of Frank H. Arlinghaus, and ROSALIE M. ARLINGHAUS, individually,
Plaintiff-Appellant,

-against-

J. RICHMOND RITENOUR and JOHN J. LIPSKY,
Defendants-Appellees,

-and-

MIRIAM PEPPER and SIDNEY PEPPER,
Defendants.

APPELLANT'S REPLY BRIEF

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On Appeal From The United States District Court For The Southern District Of New York

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APPELLANT'S REPLY BRIEF

Appellees' Brief is less significant for its contents than for what it does not contain. Ritenour and Lipsky make no attempt to deny, explain away or palliate the fact that they had knowledge at all the crucial times of utterances and actions on the part of Pepper which gave clear indication that Pepper would lie to and bring pressure and undue influence to bear on his client, Mrs. Arlinghaus, in the very transaction which is the subject matter of this action, the sale of Teleservice stock owned by Mrs. Arlinghaus and the estate.

It is understandable that Ritenour and Lipsky have failed to dispute their knowledge of Pepper's disqualification as agent for Mrs. Arlinghaus and the estate, for that knowledge was established by their own testimony in this action. Thus, Lipsky testified that, when

Pepper suggested, sometime between March 14 and April 25, 1967, that he (Pepper) tell the stockholders that Ritenour and Lipsky would quit if they did not get the Teleservice shares they wanted, Ritenour told him:

> " 'Sidney, if you ever do that, it will be a goddamn lie. You don't have my authority. We're not quitting'." (E 211).
> (See also A 110-111; Exh. E, pp. 103-104).

Ritenour testified that he found out later that Pepper, in conversations with Mrs. Arlinghaus, had used the very lie which Ritenour had prohibited:

> "A Mr. Carl Lenz of Modern Talking Picture Service called me on the telephone and said, 'What is all this crap I have heard about your threatening to quit?' and I said, 'Goddamn it, has Pepper been talking again?'
>
> Q You assumed then that Pepper was Lenz's informant?
>
> A Yes.
>
> Q Mr. Lenz said that Pepper had told him that.
>
> A I did not say that.
>
> Q That was your assumption?
>
> A It had to come from Mr. Pepper.
>
> Q Why?
>
> A Because he had been using it from time to time as I observed and found out.
>
> Q When you say 'he had been using it', what do you mean by that?
>
> A It came to my attention that he was using this in conversations with Mr. Clem Arlinghaus, Mr. Milton Lewis, and Mrs. Rosalie Arlinghaus." (A109-111)

That Ritenour understood from these occurrences that he was not justified in dealing with Mrs. Arlinghaus through Pepper is clear from his testimony about the

Rainbow Room luncheon on May 10, 1967:

> "Other than advising them about the stipulated $15 purchase price, I wanted to clear the air once and for all *and in front of Mrs. Arlinghaus* that about [*sic*] the rumors and gossip of John Lipsky and myself threatening to leave the corporation." (A 272; emphasis supplied.)

Pepper's testimony, not contradicted by Ritenour or Lipsky, shows that, immediately following the unsuccessful closing meeting with the syndicate on June 9, 1967, Pepper sat down with Ritenour and Lipsky and offered, for a fee, to engineer a purchase at an even lower price than the one promised by the syndicate:

> "A Well on June 9th, I had a meeting with Mr. Ritenour and Mr. Lipsky at a restaurant near Mr. Scharf's office.
>
> Q Was this meeting before or after the attempted closing?
>
> A After.
>
> Q Yes.
>
> A (Continuing) And I have here a memorandum which indicates that Mr. Ritenour wanted to acquire 30,000 shares of Teleservice stock at $7.50 a share sometime prior to June 19, 1967 * * *
>
> Q Have you given us your entire recollection of what transpired at the meeting on June 9th with Messrs. Lipsky and Ritenour?
>
> A There was a discussion that I was to get a fee; since the original offer was net to my people, somebody would have to pay me a fee.
>
> * * * *
>
> A Well, I had no specific agreement about the April 25th offer, as modified, and in this one, I felt that I ought to get some compensation."
> (Exh. F, pp. 133-136).

There, then, was Pepper, the purported "agent" for Mrs. Arlinghaus, asking Ritenour and Lipsky, the prospective buyers of Mrs. Arlinghaus' stock, for a fee (later changed to a stock participation at the bargain price) for bringing about the purchase of his client's property at a small fraction of its known value. What more poignant proof of infidelity can one imagine? In spite of the damaging character of this testimony, neither Ritenour nor Lipsky took the stand to contradict it.

An equally clear admission is found in Ritenour's and Lipsky's testimony about the "negotiations" with Pepper for the purchase of Pepper's clients' stock. Lipsky testified:

"A We had meetings, Mr. Ritenour and I, with Sidney Pepper, who was counsel for Modern Teleservice, and the discussion centered around Mr. Ritenour and I each getting fifteen percent shares in the company from the existing stockholders.

> Sidney thought it could be done. He did not see why it could not be done, and the [$10 purchase] plan was formulated where Mr. Ritenour and I each would get [a] fifteen percent share of the company." (A230.)

And Ritenour testified:

> "A I recall that the price formula was a suggestion by Mr. Pepper.
>
> * * * * * * * * * * *
>
> Q Was Lipsky there when he proposed it to you?
>
> A Yes."
>
> (Exh. E, pp. 268-269).

This $10 formula, of course, was proposed by Pepper at a time when it was known to Ritenour, Lipsky and Pepper that (1) Teleservice had an obligation under the stockholders agreement to purchase from the estate as many shares as Mrs. Arlinghaus should put to it at $16 a

share and (2) the actual sale value of the stock was between $34 and $51. Pepper's proposal, then, was clear notice to Ritenour and Lipsky, quite apart from their prior knowledge of Pepper's attempt to deceive Mrs. Arlinghaus in the syndicate transaction, that Pepper had stepped out of his fiduciary role and was pursuing his own interest (and theirs) to his clients' detriment. (See also the discussion in Appellant's Brief, pp. 22-24).

These admissions by Ritenour and Lipsky furnish a complete answer to all of the arguments made in the Appellees' Brief in defense of their purchase of the Arlinghaus shares We shall discuss those arguments below, utilizing the organization employed by appellees in their brief.

THE FACTS

Appellees assert (without citing to the record) that Mrs. Arlinghaus received Sonderling stock worth 1.2 million dollars for the shares remaining to her after the sale to Ritenour, Lipsky and Pepper. (Appellees' Brief, p. 9). The implication is that she was well paid for her stock. This argument is self defeating. The better the price which Mrs. Arlinghaus received for the shares remaining to her after her sale to Ritenour, Lipsky and Pepper, the greater the damages she suffered from that sale. She should have received the higher price for all of the original Arlinghaus shares, including those sold to Ritenour, Lipsky and Pepper.

POINT I

The thesis of Ritenour's and Lipsky's argument in this point is that plaintiff "erroneously attempts to impose upon Ritenour and Lipsky the degree of fiduciary responsibility which Pepper, as attorney for the plaintiff, owed to his client." (Appellees' Brief, p. 11).

Appellees' summarization of Mrs. Arlinghaus' argument is incomplete and defective. Mrs. Arlinghaus contends, first, that Ritenour and Lipsky, as officers and directors of Teleservice, a small, closely held corporation, owed independent fiduciary duties to Mrs. Arlinghaus and the estate, as shareholders of the stock of Teleservice. That proposition is soundly established by the authorities discussed at pages 25-29 of Appellant's Brief, exemplified by *Strong v. Repide*, 213 U.S. 419 (1909) and *Saville v. Sweet*, 234 App. Div. 236, 254 N.Y.S. 768 (1st Dep't. 1932), *aff'd*, 262 N.Y. 567 (1933). *Strong v. Repide, supra*, provides an additional basis for holding that Ritenour and Lipsky owed fiduciary duties to Mrs. Arlinghaus. In that case the United States Supreme Court found that the defendant officer had acted as the agent for the shareholders in the sale of their stock and that this agency, by itself, gave rise to a fiduciary duty on his part to disclose to the stockholders his knowledge of the value of the stock. Ritenour and Lipsky had assumed the same duties as agents to find a purchaser for Teleservice or its stock. (A 34; E 214-216). Ritenour and Lipsky have taken issue with none of the foregoing contentions.

Mrs. Arlinghaus contends, secondly, that since the purchase by Ritenour and Lipsky of Teleservice shares from her and the estate was a purchase of securities in an interstate transaction, Ritenour and Lipsky had a duty under Section 10(b) of the Securities and Exchange Act of 1934 to disclose all material facts to Mrs. Arlinghaus. (Appellant's Brief, pp. 29-33).

Thirdly, Mrs. Arlinghaus contends that Ritenour and Lipsky did not discharge their common law and statutory duties of disclosure. Their claim that they made disclosure to Mrs. Arlinghaus by making disclosures to Pepper as his agent fails because, on the conceded facts, they were not justified in dealing with her through Pepper as her agent. (*Supra*, pp. 1-5; Appellant's Brief, pp. 16-25).

Fourthly, Mrs. Arlinghaus contends that, quite apart from their fiduciary and statutory duty to disclose facts to Mrs. Arlinghaus, Ritenour and Lipsky are jointly liable to her with Sidney Pepper for Pepper's violation of his fiduciary duties. This is so because they received a benefit from Pepper's violation and were aware of facts which clearly showed that Pepper was acting dishonestly towards his clients in the transaction.

A. (Appellees' Brief, pp. 11-13)

Several of Ritenour's and Lipsky's summaries of Judge Werker's findings are misleading. In discussing them, we shall employ appellees' numbering. (Appellees' Brief, pp. 11-14).

4. Judge Werker did not find that Mrs. Arlinghaus, Clem Arlinghaus and Pepper agreed in their two meetings* that it would be desirable to sell the Teleservice stock at $20 per share, as Ritenour and Lipsky assert. (Appellees' Brief, p. 12). Judge Werker found that the three participants agreed that it "might be desirable" to put the stock to Teleservice at $20. (A33). The contemporaneous memorandum of the discussions shows that, of the 20,360

*Both Judge Werker and appellees' counsel erroneously placed the meetings in "late 1967." (A 33, Appellees' Brief, p. 12). Both meetings took place in December, 1966. (A62; A64).

shares of Teleservice held by the estate, no more than 2,440 would have been put to the company, in any event (E186). This finding was of importance only to Judge Werker's disposition of the claim of duress.* It is of no help to appellees on the claim of concealment. If anything, it points up the ignorance of Mrs. Arlinghaus, as well as Clem, of the true value of Teleservice.

6. Nor did Judge Werker find that Pepper knew of the *syndicate deal.* (Appellees' Brief, p. 12). He merely found that Pepper knew of the *syndicate.* (A. 35). In fact, he expressly stated that Pepper "may not have known all the details of the brokerage arrangement." (*Ibid.*). (*See* Exh. E, pp. 195-196).

10. For some unknown reason, Ritenour and Lipsky list among their selected findings Judge Werker's remark that "[p]laintiff also alleges that she was not told of the existence of the syndicate and thought the sale one directly to Ritenour and Lipsky" but that her May 12, 1967 letter belied this allegation. (A 37). (Appellees' Brief, p. 12). The quoted portion of Judge Werker's finding is utterly in error. Mrs. Arlinghaus neither alleged, testified or argued that she had not known of the existence of the syndicate. On the contrary, she testified:

> "Q. When you received Mr. Ritenour's letter of April 25, 1967, did you know that Mr. Ritenour was making an offer on behalf of someone other than himself and Mr. Lipsky;?
>
> A. *I don't recall.*" (A177; emphasis supplied).

The point that plaintiff did make with respect to her knowledge of the syndicate was that she was never told the terms of the syndicate agreement and therefore did not know of the secret commission which Ritenour and Lipsky

*Judge Werker dismissed the claim of duress on the ground, among others, that Mrs. Arlinghaus had expressed an interest in a $20 price before the syndicate's agreement to buy at $20. (A 37).

(who were acting as agents for the purpose of finding a purchaser for Teleservice) were to receive and did not know that Stat and his two associates, Zinman and Shapiro, had agreed to accept 75 per cent of the Teleservice shares for a price which was computed as $20 times the *total* number of shares, thus paying $26.66 for each share received by them. (E136-E139; Exh. E 194-195).

1, 2 and 3. (Appellees' Brief, pp. 14-19)

In an attempt to escape the holdings of cases such as *Benedict v. Arnoux*, 154 N.Y. 715 (1898) (Appellant's Brief, pp. 17-18), which refuse to impute to a principal the knowledge of a deceiving agent, Ritenour and Lipsky contend that, while Pepper had "a diversity of interest", he did not perpetrate any fraud. (Appellees' Brief, p. 14). Considering the state of the record and Judge Werker's conclusions, which led him to award punitive damages against Pepper, this contention is nothing short of amazing. Judge Werker found that Pepper had concealed from Mrs. Arlinghaus the fact that negotiations for the sale of Teleservice indicated a probable corporate value of two to three million dollars (A. 43); that he had done so maliciously or with a recklessness that betokened improper motive (A 47); and that he "both knowingly and intentionally misrepresented Ritenour's and Lipsky's position with a view towards effecting the sale, and thereby acquiring an agent's fee and/or an interest in the corporation" (A. 42). No clearer finding of fraud can be imagined. There is, finally, no reason to think that *Arnoux, supra*, and its progeny are limited to fraud in the sense of common law deceit. The reasoning on which those cases are based is equally applicable to fraud in any manifestation.

Ritenour's and Lipsky's arguments (Appellees' Brief, pp. 15-19) with respect to *Farr v. Newman,* 14 N.Y.2d 183, 250 N.Y.S.2d 272 (1964) are answered completely in Appellant's Brief, pp. 21-25. Even if we were to assume that the *dictum* from Judge Burke's opinion on which appellees rely is the law of New York, it would not govern the instant case, in which it was demonstrated, by appellees' own testimony, that they had notice and actual knowledge that Pepper was not properly and faithfully discharging the functions of an agent. Whether the situation be analyzed as one involving third parties who, in the word of Section 271 of Restatement of Agency 2d, "[have] notice of the agent's adverse purpose" or as a case of no agency at all, the result is that Ritenour and Lipsky could not discharge their duty of disclosure to Mrs. Arlinghaus by making disclosure only to Pepper.

4. (Appellees' Brief, p. 19).

Ritenour and Lipsky claim that Pepper's disqualification did not occur until he acquired an interest adverse to his client, and they place that event at June 9, 1967, the day on which the syndicate collapsed and Pepper asked Ritenour and Lipsky for a fee for bringing about a sale directly to them (*supra*, pp. 3-4). They also claim that no negotiations or other material events took place after June 9, 1967.

This reasoning has three weaknesses. In the first place, Ritenour and Lipsky were on notice as early as April or May, 1967 that Pepper would lie to and bring pressure and undue influence to bear on Mrs. Arlinghaus in order to effectuate a sale of her Teleservice stock if he saw it to his advantage. At least from that time, Ritenour and Lipsky were not justified in treating Pepper as Mrs. Arlinghaus' agent for purposes of the necessary disclosures. This would

have been true even if Pepper had had no personal interest in the transaction. In the second place, it is undisputed that Pepper did have, or that he attempted to get, a personal stake in the syndicate transaction, which was formulated as early as April and put in final form in May, 1967. Judge Werker so found. (A. 35). Finally, many of the material events which Ritenour and Lipsky disclosed only to Pepper took place after June 9, 1967. (See *infra*, POINT II).

5. (Appellees' Brief, pp. 19-20)

Ritenour and Lipsky contend that there is no proof of intent to defraud on their part.

The Common Law Duty. Ritenour's and Lipsky's common law duties as fiduciaries, of course, were not dependent on any specific intent to defraud. That duty prohibited them from buying Teleservice stock without full disclosure of all relevant facts. See the authorities discussed in Appellants' Brief, pp. 25-29.

Rule 10b-5. The requisite intent to defraud or recklessness (*See Ernst & Ernst v. Hochfelder*, 44 U.S.L.W. (Sup. Ct.) 4451, 4454, fn. 12 (1976)) is amply demonstrated by the evidence discussed above. The requisite intent or recklessness is inferable from the very fact that, although they had knowledge of Pepper's improper actions and designs, Ritenour and Lipsky imparted material knowledge in their possession to Pepper only, and not to Mrs. Arlinghaus.

C. (Appellees' Brief, pp. 20-21).

In this section of their brief, Ritenour and Lipsky apparently mean to argue that Clem Arlinghaus knew all of the material facts which were concealed from Mrs.

Arlinghaus and that Mrs. Arlinghaus was chargeable with the knowledge possessed by Clem. This is a gross distortion of Judge Werker's findings, the record and the applicable law.

Judge Werker held neither that Clem Arlinghaus knew all of the material facts which were concealed from Mrs. Arlinghaus nor that Mrs. Arlinghaus was chargeable with Clem's knowledge. Judge Werker carefully limited his holding with respect to imputed knowledge to the knowledge possessed by *Pepper,* the attorney for Mrs. Arlinghaus. Judge Werker's conclusion with respect to Clem was, not that Clem knew all that Pepper knew, but that, as a director of Teleservice, he "was in a position to fairly estimate the sale value of the corporation." (A. 45).* Judge Werker did not attempt to impute any knowledge of any estimate that Clem might have made to Mrs. Arlinghaus but held that, in the exercise of due diligence, she should have conferred with Clem before selling her stock (A 45). We have discussed this holding in Appellant's Brief, pp. 30-33.

POINT II

In this Point Ritenour and Lipsky cite to the standard authorities on the requirement of materiality in a 10b-5 action and then proceed to argue their case on a state of fact bearing no resemblance to the facts in the record herein. They assert that there were no offers and proposals not disclosed to Mrs. Arlinghaus and that she is attempting to hold them liable because of their "expertise and understanding of the field in which Teleservice was involved."

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*This conclusion is irreconcilable with Judge Werker's findings that Clem Arlinghaus thought that $20 was a desirable price (A 33) and that he agreed to the sale to the syndicate at that price. (A 36).

(Appellees' Brief at 22). The only reason for this gratuitous statement appears to be that appellees have found a passage in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848-49 (2nd Cir. 1968), to the effect that an insider buyer need not give an outsider seller the benefit of his superior financial or other expert analysis. Suffice it to say that Judge Werker found that Ritenour and Lipsky's negotiations for the sale of Teleservice indicated a probable corporate value of two to three million dollars. This finding is soundly supported by the record, which showed an almost unbroken string of negotiations, involving many persons and firms, from October of 1966 through July 28, 1967, the effective date of the $10 purchase agreement. Appellees have not taken issue with Judge Werker's finding in this respect.

Furthermore, appellees cannot argue that Mrs. Arlinghaus did not rely on the proven non-disclosure. As stated by the Supreme Court in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972):

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of his decision."

Thus, as this Court stated in *Titan Group, Inc. v. Faggen*, 513 F.2d 234, 239 (2d Cir. 1975):

> "[I]n instances of total non disclosure, . . . resort must perforce be had to materiality, i.e., whether a reasonable man would attach importance to the alleged omissions in determining his course of action. . . . And determination of materiality allows logically an inference of reliance. *Chris-Craft Industries Inc. v. Piper Aircraft Corp.*, 480 F.2d 241 (2d Cir.), cert. denied, 414 U.S. 910, 94

S.Ct. 231, 38 L.Ed.2d 148 (1973). See, generally, Note 88 Harvard L. Rev. 584 (1975)."

In the instant case, appellees' knowledge that their negotiations on behalf of Teleservice indicated a corporate value greatly in excess of their offer to Mrs. Arlinghaus is, indisputably, material. *See* cases cited in Appellant's Brief, at p. 28. A reasonable man would surely "attach importance" to the fact that stock he was selling for $10 a share was worth $34 to $51 a share.

POINT III

Ritenour and Lipsky are mistaken in asserting that Mrs. Arlinghaus did not raise in the trial court her contention that Ritenour and Lipsky are liable with Pepper for Pepper's breaches of fiduciary duties. (Appellees' Brief, p. 23).

At pp. 50-51 of Plaintiff's Post-Trial Brief, served and filed on June 24, 1975, Mrs. Arlinghaus made the following argument:

> "While Pepper's breach of his duty as an attorney is of a different character from the breaches of the duties owed by Ritenour and Lipsky, the latter two defendants nevertheless became liable for Pepper's breach of those duties. Those who knowingly join with a fiduciary in the violation of his fiduciary duties become jointly and severally liable with him. *Jackson v. Smith*, 254 U.S. 586, at 589 (1930); *Irving Trust Co. v. Deutsch*, 73 F.2d 121, at 125 (2d Cir. 1934). In short, defendants are jointly liable for the entire damage suffered by plaintiff, and each is severally liable for that entire damage. *Marcus v. Otis*, 168 F.2d 649, at 658-59, *reaff'd*, 169 F.2d 148 (2d Cir. 1948)."

This is the argument which, with citation of additional authorities, Mrs. Arlinghaus has repeated in POINT III of Appellant's Brief.

POINT IV

In their final point, appellees assert that, even if Mrs. Arlinghaus was defrauded by them, she cannot recover any of her damages from Ritenour and Lipsky because her claims are barred by the defenses of (i) lack of due diligence, (ii) waiver and (iii) equitable estoppel. None of these defenses are applicable to the undisputed facts herein.

A. Lack of Due Diligence

Appellees assert that they are not liable to Mrs. Arlinghaus for their failure to disclose to her their knowledge of the value of Teleservice, since she did not obtain an independent valuation of the company. Thus, appellees rely on Judge Werker's holding without attempting to answer Mrs. Arlinghaus' argument (Appellant's Brief, pp. 30-33) that application of the due diligence requirement is precluded by Judge Werker's findings that Mrs. Arlinghaus was "unsophisticated in stock transactions" (A36) and that she made the sale of her stock "in total reliance on Pepper"—a person on whom she was entitled to rely, since he was her attorney as well as counsel for Teleservice.

Ritenour and Lipsky do not contest Judge Werker's findings, nor could they, for the evidence clearly shows that Mrs. Arlinghaus was far from being an experienced, sophisticated or informed investor. Nevertheless, relying solely on *Caan v. Kane-Miller Corp.*, 1975-76 CCH Federal Securities Law Reporter Transfer Binder, ¶95,446 (S.D.N.Y. 1976), a case which is totally inapposite to the instant action, they continue to assert the lack of due diligence in their attempt to retain the unconscionable profits which they derived from their transaction with her.

In the *Caan* case, Judge Conner merely ruled that there had been full disclosure of the fact which, plaintiff had alleged, was not disclosed and that, as a result, the claim under Rule 10b-5 must fail. *Id.* at 99,241.*

In *Caan*, the defendant allegedly failed to disclose that a fundamental transition had occurred in its business approximately one year before purchase of its stock by the plaintiff, "concededly a sophisticated company whose very business is acquiring other, smaller companies." *Id.* at 99,242. Judge Conner ruled:

> "By examination of [defendant's] books and records [plaintiff] should have, and I am convinced did, discover the transition prior to the acquisition. . . . In the course of complicated merger negotiations, there is no affirmative duty to direct a sophisticated purchaser, such as [plaintiff], to all routine information which it should be expected to uncover during the course of a reasonable investigation." *Ibid.*

Appellees' attempt to bring the instant action within the limited rubric of *Caan* borders on the absurd. First, Mrs. Arlinghaus is the antithesis of the wheeler-dealer, corporation acquiring, merger partner in *Caan*. She is a physical therapist (A 142), who owned shares of Teleservice only because they were given or bequeathed to her by her late husband, its founder, and, as discussed *supra*, was totally "unsophisticated in stock transactions." (A 36).

Second, unlike *Caan*, there is no issue in the case at bar as to whether appellees' knowledge of the value of the stock had been disclosed to Mrs. Arlinghaus. Judge Werker not only made a specific finding of fact that there was no such

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*Although the Rule 10b-5 claim in *Caan* was actually asserted as a counterclaim, for the sake of clarity, the person asserting the claim will herein be referred to as the "plaintiff" and the alleged violator of the Rule as the "defendant."

disclosure (A 43), but he also imposed both compensatory and punitive damages on Pepper because of that non-disclosure. Thus appellees' reliance on a case in which the trial judge was "convinced" that the allegedly undisclosed fact was disclosed to the plaintiff is totally misplaced.

Finally, the instant action is distinguishable from *Caan* because the fact that was concealed from Mrs. Arlinghaus, *i.e.*, "that negotiations for the sale of [Teleservice] indicated a probable corporate value of two to three million dollars" (A 43) is not the type of "routine information which [should be discovered] during the course of a reasonable investigation" of a company's books and records. *Caan, supra* at 99,242. Because appellees were conduting the negotiations which Judge Werker found had indicated the two to three million dollar corporate value, only they and those to whom they chose to disclose that information were cognizant of that fact. Thus, it was appellees' knowledge, derived from negotiations conducted by them, which was concealed from Mrs. Arlinghaus. *See Wassel v. Eglowsky*, 399 F. Supp. 1330, 1365 (D. Md. 1975).

Appellees' reliance on *Caan, supra,* is even more surprising in light of Judge Conner's efforts to distinguish that spurious 10b-5 claim from legitimate grievances asserted by defrauded buyers and sellers of securities. He reaffirmed the holding of *Stier v. Smith*, 473 F.2d 1205, 1207 (5th Cir. 1973), that "sophisticated investors, like all others, are entitled to the truth", *Caan, supra,* at 99,242, a principle of law that has hitherto been unchallenged. *See also Welch Foods, Inc. v. Goldman, Sachs & Co.*, 398 F. Supp. 1393, 1399 (S.D.N.Y. 1974); *Newman v. Shearson, Hamill & Co.*, 383 F.Supp. 265, 268 (W.D. Tex. 1974). In the instant case, Mrs. Arlinghaus was also entitled to the truth—that appellees knew that shares of Teleservice were worth three to five times the amount which they offered her.

B. Waiver

Appellees also urge that Mrs. Arlinghaus has somehow waived her right to rescind the fraudulent sale* because she did not immediately rescind the transaction upon announcement of the Fuqua offer which, appellees infer, exposed their fraudulent non-disclosures to her. Once again, appellees misconstrue the applicable law, distort the facts of this case and seek to overturn the findings of Judge Werker.

First, appellees ignore the applicable rule of law where rescission is sought because of fraud perpetrated by a fiduciary:

> "The concept of due diligence is not imprisoned within the frame of a rigid standard; it is protean in application. A fraud which is flagrant and widely publicized may require the defrauded party to make immediate inquiry. On the other hand, one artfully concealed or convincingly practiced upon its victim may justify much greater inactivity. The presence of a fiduciary responsibility or evidence of fraudulent concealment bears heavily on the issue of due diligence." *Azalea Meats, Inc. v. Muscat*, 386 F.2d 5, 9 (5th Cir. 1967).

Ritenour and Lipsky owed fiduciary responsibilities to Mrs. Arlinghaus. *See* Appellant's Brief at 25-29. Thus, and especially because of the strong disfavor in which the defense of waiver is held in securities cases, *Wilko v. Swan*, 346 U.S. 427, 438 (1953), Ritenour and Lipsky cannot preclude rescission by Mrs. Arlinghaus simply by claiming that she ratified their fraud.

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*Of course, even assuming, *arguendo*, that rescission relief is not available, "the avenue of damages is still open . . . ." *Johns Hopkins Univ. v. Hutton*, 488 F.2d 912, 916 n.12 (4th Cir. 1973), *cert. denied*, 416 U.S. 916 (1974).

Furthermore, the facts preclude a finding of waiver. As soon as Mrs. Arlinghaus discovered that Pepper had taken unfair advantage of his position as her attorney, she discharged Pepper and retained other counsel. (Appellant's Brief, p. 3). Appellees concede that this action was instituted shortly thereafter. (Appellees' Brief, p. 26). When coupled with Judge Werker's finding that she relied entirely on Pepper (A 38), it is clear that (i) so long as Pepper was her attorney, Mrs. Arlinghaus could not be expected to bring suit and (ii) once his fraudulent activities were uncovered, Mrs. Arlinghaus acted promptly to institute the instant action.

Finally, the announcement of the Fuqua offer in November of 1967 did not, by itself, establish the fraudulent concealment. The mere fact that one company contracted to pay more for Teleservice stock than Ritenour and Lipsky had paid to Mrs. Arlinghaus earlier did not mean that Ritenour and Lipsky knew, at the time of their purchase, that Teleservice stock was worth more than they paid. Fuqua may simply have been willing to pay a higher price because of events subsequent to the Arlinghaus transaction or for any other reason which would not be indicative of fraud. In any event, by holding Pepper liable to her for his participation in the fraud, Judge Werker found that Mrs. Arlinghaus did not waive her right to rescission. This issue is clearly a factual issue better left to the trier of fact. *Johns Hopkins University v. Hutton, supra* at 918.

C. Equitable Estoppel

Ritenour's and Lipsky's attempt to bring themselves within the maxim of equitable estoppel — "where one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss

must sustain it" — is also misplaced. By virtue of their conduct in purchasing the Teleservice stock of Mrs. Arlinghaus and the estate at a fraction of its actual value without disclosing to her their knowledge as to that value, they fail to qualify as "innocent" persons. See *Federal Ins. Co. v. Groveland State Bank*, 44 App. Div.2d 182, 354 N.Y.S.2d 220, 228 (4th Dep't 1974).

Furthermore, Mrs. Arlinghaus is merely seeking rescission of the transaction. Ritenour and Lipsky, even if "innocent" of Pepper's fraud, hardly suffered because of it. On the contrary, they benefitted mightily from that fraud. Thus, the issue in this case is not whether Ritenour and Lipsky, on the one hand, or Mrs. Arlinghaus, on the other, should sustain a loss, but rather, whether Mrs. Arlinghaus should be required to sustain a loss while Ritenour and Lipsky are allowed to retain the compensating gain. No maxim of equity can justify that result.

CONCLUSION

The Court should reverse the judgment of September 30, 1975 by which the district court dismissed Mrs. Arlinghaus' claims against Ritenour and Lipsky and should direct judgment in favor of Mrs. Arlinghaus against Ritenour for an accounting and against Lipsky for damages.

Respectfully submitted,

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